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March 10, 2009

The Honorable Michael E. Fryzel
Chairman, National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

The Honorable Rodney E. Hood
Vice Chairman, National Credit Union Administration

The Honorable Gigi Hyland
Board Member, National Credit Union Administration

Re: Comments on Advanced Notice of Proposed Rulemaking for Part 704
Sent via email to: regcomments@ncua.gov

Dear Chairman Fryzel, Vice Chairman Hood, Board Member Hyland:

Credit Unions are cooperatives chartered by an act of Congress in 1934 to fulfill an important role for consumers as an alternative to the for-profit model of banks. That role is as important today as it has been in any part of our history.

Credit Unions in turn formed Corporates under the same not-for-profit Rochdale principles to meet their financial needs as an alternative to for-profit or banking entities, which were charging high fees, paying lower rates, and using those profits to eliminate the Credit Union competition. Credit Union's need Corporates today as their member-owned, not for profit aggregator to gain economies of scale related to investment, liquidity, and payment systems needs.

The world has entered a financial crisis not seen since the Panic of 1907 or the Great Depression. Credit Unions did not create the current financial chaos, but we have certainly been impacted by this 100-year event. With that in mind, great care and diligence is required to make the important changes that will assure Credit Unions existence and success for the next 100 years. Establishing regulation that prematurely focuses on just the Credit Union Movement and particularly Corporates, without the context of history and the greater financial market place could lead to unintended consequences. If the point of new regulation is to establish rules that promote safety and soundness while allowing the industry to be successful within that scope, we applaud the efforts. The establishment of new regulation in the midst of the "perfect storm" without careful

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post-mortem analysis is short-sighted, and could lead to conclusions that could be devastating to the success of Credit Unions

We are thankful that the NCUA acted quickly to infuse capital into U.S. Central simultaneously with U.S. Central's announcement of $1.2 billion in Other Than Temporary Impairment (OTTI). This action along with the guarantee of Corporate shares, helped to keep confidence in the Corporate Network. The action was necessary because of the rules of Financial Accounting Standard (FAS) 157. If FAS 157 was suspended by the NCUA (and all financial regulators) as a GAAP/RAP difference, then U.S. Central would not have required the infusion, and this panic would have been avoided, despite the large announced losses which would have been covered by existing capital.

Corporates and the Corporate Network have grown over time, from matched book pass-through entities, into complex money and payment system managers. All risks taken were within the established rules and regulations of the NCUA, which were viewed by most stakeholders as prudently conservative.

The liquidity element, including the use of the CLF, worked as it was designed, despite the total seizure of the global securities and housing marketplace. Once again, Credit Unions and Corporates have been at the end of this global crisis, not the beginning and while the pain is great, it is far less than the costs that banks will eventually pay.

We respectfully ask that open dialog be permitted after careful analysis of the causes to this global meltdown to assure that the best possible solutions are considered.

Sincerely,

Thomas R Graham

Thomas R. Graham
President and CEO

Attachment: Response to ANPR

Response to ANPR

Payment System Proposals

1. Should payment system services be isolated from other services to separate the risks?
    a) If so, what is the best structure for isolating these services from other business risks?

   Response: No. Separating business lines into separate entities could create greater risks and higher costs for NPCUs. To attempt to eliminate risk, as opposed to manage risk, will lead to significantly greater costs for NPCUs and will eliminate options for NPCUs to conduct their business in a cooperative system model, without reliance on for-profit or banking companies.

   Corporates should consider more aggregation of payment system platforms, which would further reduce operating costs for NPCUs, provide for systems that are more reliable and improve back-up systems, as payments continue to convert to electronic means. This should be determined by NPCUs and their Corporates, not dictated through regulation.

2. Should there be a charter that strictly limits Corporates to operating a payment system only?

   Response: No. There are currently other payment system alternatives. These alternatives are often more expensive and burdensome to operate than those provided by Corporates. The Federal Reserve System is an example. NPCU members find that working directly with the Fed often costs more money, more time and find there is only one price, regardless of volumes or asset size. The current Corporate payment system allows for the benefit of synergies and aggregated cost savings, while providing a simplified business model for NPCUs to access.

   While payment systems appear to be a business line that can be separated from the Corporate charter, it will lead to duplication of costs and therefore higher fees to NPCUs, and increased capital requirements which would come from NPCUs. Separate systems would also require more cash management and staff time for NPCUs. Additional liquidity management and settlement management would further increase NPCU costs. The current payment system is more effective and efficient for NPCUs. NPCUs already have choices in payment systems and should be permitted to maintain a cooperative alternative.

3. Is there sufficient earnings potential in offering payment systems to support a limited business model that is restricted to payment systems services only?
   Response: No. This question will be very difficult for most NPCUs to answer because it requires insight into the back offices and cost structure of Corporates. Most Corporates are providing payment systems at a break-even price, if not a loss, as a point of convenience to obtain investment and settlement dollars. Corporates' business model generates revenue through investments, not through processing payments. Putting these services into separate entities, would require new capital and increase cost to NPCUs.

   Regulation should address the proper capital allocation or settlement risk charge to the business and allow the Corporate Credit Unions the opportunity to establish a well designed business model and plan. Moving payment systems into a separate entity could increase overhead costs and force that inefficiency back to the NPCUs unless more consolidation occurred. Separation would lead to duplication of overhead, as well as redundancy requirements and controls, making this option very costly for NPCUs.

<u>**Liquidity and Liquidity Management Proposals**</u>

1. What steps should be taken, and by whom, to preserve and strengthen Corporates' ability to offer liquidity services?
   Response: The Corporates provided liquidity, up to and through the point that the world's financial markets stopped working and CUs stopped funding their loan growth with retail deposits. A very important element of our Corporate system, the CLF was required, because the liquidity stresses of the world financial markets impacted Credit Unions. If the Agency removes all the risk of liquidity management at the Corporate level due to this 100-year event, costly additional liquidity risk management will be required of NPCUs. Corporate liquidity is based on NPCUs' business plans and models and includes leveraging these funds to gain additional returns for holding short duration investments.

   Liquidity management is primarily the responsibility of NPCUs, their management and Board and secondarily, at the Corporate level as a safety mechanism. Corporates provide emergency back-up to NPCUs if liquidity cannot be self-managed, and the CLF in turn to Corporates if liquidity can not be self-managed at that level. This system worked. We should be grateful that the system was well designed to meet this 100-year event. The CLF should also be a

direct source for Corporates to utilize for both borrowing and deposit for stressed times like these.

2. Should the NCUA consider limiting a Corporate's ability to offer other specific types of products and services in order to preserve and defend the liquidity function?
    a) What specific types of products and services should Corporates be authorized to provide?

   Response: The Agency should determine the policy framework to control and mitigate risks, not use a deterministic model. The current regulation provides adequate tools to mitigate the risks on Corporate Credit Union balance sheets. If the capital requirements of Corporates will mirror those of the FDIC-insured financial institutions, as asked later in this ANPR, then commensurate authorities should be granted to Corporates by the agency. Corporates must be permitted to have a full spectrum of cooperative products and services. NPCUs should not be limited to for-profit options often run by our competitors at profits that are used to support stockholders and the bank's stated goals to put Credit Unions out of business.

3. Should the NCUA add aggregate cash flow duration limitations to Part 704?
    a) If so, describe how this requirement should be structured, and also identify how such limitations would benefit liquidity management.

   Response: There may be benefits to adding cash flow duration limits as well as loan to share or debt to share ratios at both NPCUs and Corporates. However, significant restrictions can cause just as many problems and unintended consequences during extraordinary periods as we are in today. These restrictions, while protective of losses in illiquid markets, may not allow proper risk-taking necessary to provide acceptable returns on members' capital and could lead to disintermediation and reduced liquidity within the system.

    b) What cash flow duration limits would be appropriate for Corporates particularly in an evolving interest rate market with previously unseen credit risk spreads?

   Response: As noted above, this would need to be analyzed carefully in various scenarios so as not to cause new unintended consequences. This is the first time in recent memory when both liquidity constrictions occurred at the same time that credit spreads widened. Because these two stresses lead to a global market dislocation, new measures need to be considered. It may be appropriate to consider increased standards as spreads between

LIBOR and Treasuries narrow and less when margins are in a wide range. Minimum cash holding standards or maximum loan to share or loan to debt ratios may assist with this concern. This would require extraordinary duration management and will negatively impact rates and dividends to members. Again, NPCUs should not be held to a greater standard than banks.

Field of Membership Issues

1. Should the agency return to defined FOMs to address what they perceive as risk associated to expanding FOM?
   Response: No. This could easily and quickly become the precedent to limit NPCUs FOMs. Using the Federal Home Loan Bank model as an example, their limitation on membership did not protect them from having similar consequences to the current market, nor did it assist in making each stand-alone bank more competitive. We have fought too hard against the banks to expand arbitrary FOM restrictions. Clearly, NPCUs have utilized the Corporate's open FOM to their advantage, by joining multiple Corporates (often at examiner's insistence), and negotiating to their benefit, for the highest rates possible. This, in turn, drove Corporates' NII margins down, resulting in weaker capital.

   An alternative to limiting Corporates' FOM is to require that all NPCUs capitalize any Corporate that they utilize for investment purposes. The capital requirements will cause NPCUs to make investment decisions carefully while increasing the capital level in Corporate's. Underperforming Corporates will liquidate or merge to meet members' needs. This is a much more "market driven" response than limiting Corporate's FOMs.

Expanded Investment Authority

Currently, Part 704 provides an option by which Corporates meeting certain criteria can qualify for expanded investment authority.

1. Does the need for expanded authorities continue to exist?
   a) If so, should NCUA modify the procedures and qualifications by which Corporates currently qualify for expanded authorities?

   Response: The need for expanded authorities still exists. There is an argument that investment authorities need to be expanded beyond the current narrow regulatory restrictions, which forces a concentration risk at all levels of the credit union system.

   For example, credit unions carry the greatest concentration in mortgage-based assets followed by auto and credit card-based

loans. Because of the current restrictions on Corporate investment authorities, Corporates also have a concentration in securities based on mortgages, autos and credit cards, thereby increasing a NPCU's concentration risks, on a "see through" basis. Corporates should be permitted to invest in areas that NPCUs cannot invest in, as long as they have been grated expanded authorities.

Today, there appears to be sufficient capital in the Credit Union System, as quoted by the NCUA Chairman and the former Secretary of the Treasury, Paulson. However, it is not aligned with the risks, which is also why the NCUA is appropriately considering a realignment. For example, those Corporates who do not have any expanded investment authorities, and utilize U.S. Central as a sole-source investment option, have the highest capital levels, because they have "pushed" the risks up to US Central, without contributing commensurate capital to U.S. Central. Those Corporates with the highest investment authorities have the lowest capital levels, because they have assumed the risks as granted by expanded authorities. There is a need to align capital requirements with risk and, to potentially increase capital requirements for the protection of 100-year events.

Investment authorities should be aligned with greater capital requirements as greater risk requires greater controls, monitoring and greater capital. NPCUs would be surprised at the rigor that the NCUA currently requires in its application to gain additional authorities as well as the additional costs to measure and monitor operations.

b) If so, what should the new standards be?

Response: The greater the authorities, the greater the capital requirements. In no case should CUs be more restricted than banks. If CUs are required to move to bank-like capital standards or the standards included in BASEL, then similar investment authorities should be permitted for Corporates.

2. Should NCUA reduce the expanded authorities available?

a) If so, which ones?

Response: No, in fact Corporates may need additional authorities to counter the overweighting that occurred during the 2008 liquidity crisis. For example, NPCUs have a natural overweight in mortgage loans. In addition, they have increased their excess cash investments in mortgage-backed securities. At the Corporate level, we too have increased our investments in mortgage-based securities for greater returns. To add to the overweighting, U.S. Central also has significant exposure mortgage related securities. This all

happened because mortgage based investments, either in loans or securities, were considered safe. As noted earlier, Corporates should be permitted to invest in areas that counter the industry overweighting in addition to being permitted to invest in an overweighed safe area. CUs are already more restricted than banking counter parts, yet we are quickly moving to the same capital standards as banks. This furthers the competitive disadvantages of our cooperative model.

3. Alternatively, should any of the limits in existing expanded authorities be reduced or increased?
   a) If so, which ones?

   Response: As noted above, increased authorities should follow increased capital standards despite the greater flexibility to manage risk. Additional investment alternatives should be considered to avoid the "overweight" in particular areas.

4. Once granted, should NCUA require periodic requalification for expanded authorities?
   a) If so, what should be the timeframe?

   Response: The current and annual review process is or should be sufficient, for the NCUA to determine if all standards are being maintained for the expanded authorities. The annual examination should include a review of the authorities and controls and qualifying criteria. The process that Corporates go through for expanded authorities and as part of the annual review process is very rigorous and deeper than that of NPCUs. "Requalification" may become very cost intensive, as opposed to the current examination process being complete enough to assure compliance with all regulations including expanded authorities.

<u>Structure: Two-tiered System</u>

The Corporate system is made up of two-tiers: a retail network of Corporates that provide products and services to NPCUs, and a single, wholesale Corporate (U.S. Central) that exclusively services the retail Corporates.

1. Does the two-tier Corporate system in its current form meet the needs of credit unions?

   Response: This two-tier system has functioned well. There are other alternatives that the Corporate Network has already recommended to the NCUA. One proposed alternative is to reduce U.S. Central to a liquidity aggregator and off-balance sheet CUSO as opposed to the current investment source for the majority of Corporates. U.S. Central's staff, at the direction of their Board, is already reducing the size of their balance sheet through natural run-

off and limiting deposit growth, through pricing. This reduces risk by re-aligning risk back to Corporates who are willing to operate as stand-alone Corporates as opposed to branches of U.S. Central; it also reduces the duplicate cost of operations. Regulations should be focused on policy issues to protect the consumer and their organization, not with designing business models. NPCUs, through their elected representatives, should determine the appropriate business model within the laws they wish to operate. The regulator should assess compliance to the regulation. The insurer should assess risk. It appears that the lines have blurred.

2. Is there a continuing need for a wholesale Corporate credit union?
   a) If so, what should be its primary role?

   Response: This decision should be made by the owners and governing bodies, not the regulators or insurers. Regulators should not be business opinion leaders, or the builders of business models. The Corporate Network made recommendations to the NCUA on a potential beneficial use of a wholesale CUSO for Corporates late in 2008.

3. Should there be a differentiation in powers and authorities between retail and wholesale Corporates?

   Response: Not necessarily. The wholesale Corporate (U.S. Central) is owned and operated by Corporates as a CUSO. That CUSO was formed to support the collective needs of its owners utilizing cooperative principles. This governance model is appropriate, but could be improved as noted in another section. Also, as previously noted, the U.S. Central Board is already changing the balance sheet and business model of U.S. Central.

   There may be a need to require more capital or risk sharing due to the expanded authority levels. The business needs of the members should determine the needs and requirements to complete the business model whether it is an integrated, vertical, or horizontal model. Setting powers too definitively could set precedent that if extended could lead to the regulator choosing winners and losers based on arbitrary rules or regulatory bias.

4. Does the current configuration result in the inappropriate transfer of risk from the retail Corporates to the wholesale Corporate?

   Response: There is not an "inappropriate transfer of risk". If any activity was inappropriate, regulators would have stopped the inappropriateness long ago with their extensive and existing powers. There should be a better balance between risk and capital requirements as noted earlier, and the Corporate Network may need additional capital.

5. Should capital requirements and risk measurement criteria (e.g., NEV volatility), be different from those requirements that apply to a retail Corporate credit union?

   Response: Safe and measured requirements should always be maintained. The proper risk measures and capital should be determined through the business model requirements. If a wholesale Corporate is a pass-through entity and risk is not borne at the Corporate, then additional capital is not needed. As proposed earlier, if the wholesale Corporate is a CUSO with limited balance sheet capacity, the risk and capital requirements should be lower.

Corporate Capital

NCUA is considering revising various definitions and standards for determining appropriate capital requirements for Corporates. These changes would bring the Corporate capital requirements more into line with standards applied by other federal financial regulators.

Another issue under consideration is whether to require a certain level of contributed capital from any natural person credit union seeking either membership or services from a Corporate.

Core Capital

Under the current rule, core capital is defined as retained earnings plus paid-in capital.

1. Should the NCUA establish a new capital ratio that Corporates must meet consisting only of core capital, and if so, what would be the appropriate level to require?

   Response: NCUA should continue the use of RUDE plus paid in capital. However, the NCUA should also include non-GAAP qualified capital as part of the capital ratio and not distinguish between types of capital as the rating agencies currently do. The volatility of Corporate balance sheets due to NPCU liquidity needs requires a flexible capital approach and the current Member Capital Shares meet that need. Until the non-qualified paid in capital meets its expiration term limitation, the NCUA would charge that capital account for any loss exceeding RUDE and GAAP qualified paid in capital and before charging Member Capital Shares.

   The NCUA should support Corporates by permitting Corporates to include or convert non-GAAP capital to perpetual capital in today's environment to further strengthen total capital. The NCUA should consider increasing total capital standards for expanded authorities, without additional requirements on types of capital.

Risk-based capital, as has been suggested by Corporates several years ago, should be considered again by the Agency. It appears the NCUA is moving to a BASEL standard., Caution is required, because BASEL organizations have many more authorities than Corporates. Holding Corporates to the same capital levels, without permitting them to have the same level of authorities, will lead to underperformance and disintermediation, which could lead to the demise of the Corporates and many credit unions that Corporates support.

2. What actions are necessary to enable Corporates to attain a sufficient core capital ratio?
   Response: The NCUA should permit Corporates to obtain outside or secondary capital issued to non-credit union entities. This would require the NCUA to also permit non-CU directors to sit on Corporate Boards. The NCUA should support including all paid in capital as core capital and assist Corporates in converting term PIC to GAAP-qualified PIC.

3. What would be an appropriate time frame for Corporates to attain sufficient capital?
   Response: Corporates have sufficient capital under today's regulations, but additional flexibility to attain capital under stressed balance sheet conditions, as are present today is required. If capital standards are increased, sufficient time must be permitted so as not to create an unfair disadvantage to NPCUs during the capital-growing phase.

4. What is the appropriate method to measure core capital given the significant fluctuation in Corporate assets that occur?
   Response: Risk-based capital would assist Corporates in managing capital based on balance sheet risk while dealing with asset fluctuations that can increase or decrease quickly because of NPCU's liquidity needs. As a liquidity provider and a cooperative, we must be able to grow and shrink the balance sheet to meet members' needs.

5. What is the correct degree of emphasis that should be placed on generating core capital through undivided earnings?
   Response: The higher the requirement for RUDE, the less competitive NPCU members will become because under current regulations, net income is the only way for Corporates to increase RUDE. Corporates operate under very thin margins. The regulation must consider all capital and stop distinguishing between levels as it has been proven all NPCU capital is at risk if there is a loss.

6. Should there be a requirement that a Corporate limit its services only to members maintaining contributed core capital with the Corporate?
   Response: Yes. This change in regulation will help keep the playing field level and require NPCUs to determine the number and size of Corporates (let the market decide winners and losers; not the regulators or insurers). The NCUA should also assure that all Corporates have similar capital standards in terms of contractual conditions and based on investment authorities utilized and other products provided.

7. Offer any other suggestions or comments related to core capital for Corporates.
   Response: All paid in capital should be converted to similar terms and conditions. All Corporates should have the same capital standards and instruments with the same features and conditions.

<u>Membership Capital</u>

1. Should the NCUA continue to allow membership capital in its current configuration, or should the agency eliminate or modify certain features, such as the adjustment feature, so that membership capital meets the traditionally accepted definition of tier two capital?
   Response: As stated earlier, all NPCU capital is at risk. All capital should be included in minimum requirements. Allowing MCS type capital to grow and shrink may be very beneficial for the system in times of tight liquidity. Corporates need to have some flexibility to manage balance sheet fluctuations.

2. Should adjusted balance requirements be tied only to assets?
   Response: Yes, and possibly applied consistently to all Corporates. In part, this is a cost for access to a system. If deposits in the Corporate were used instead of assets, it could create a "gaming the system" opportunity and would be detrimental. There are many alternatives to a formula based system, and simple should be the guide.

3. Should the NCUA impose limits on the frequency of adjustments?
   Response: The business model of each Corporate should determine the need for capital accounts and the frequency of possible adjustments unless the NCUA imposes unilateral standards. Any proposed regulation should provide capital flexibility. The Agency should focus on adequacy not mechanics of capital account application.

4. Should the agency require that any attempted reduction in membership capital based on downward adjustment automatically result in the account being placed on notice, within the meaning §704.3(b)(3), so that only a delayed payout after the three-year notice expires is permissible?
   Response: No, this would be an unnecessary restriction. As noted in the previous questions, the Agency should focus on capital adequacy, the Corporate Board and management should determine the need for capital to support the business model. In the event a capital payout would cause unsafe or unsound operating environment, the Agency has adequate supervisory tools to fix that problem. The regulation should address the ability to offer services and pricing differentiation between capital shareholders and those that are not. Today, these accounts cannot be paid out until the 3-year notice period expires. The NCUA should support a "no free option" requirement that any NPCU that gives notice would not be entitled to all the same products and services at the same rates as NPCUs who choose to support their Corporate.

5. Should there be a requirement that any withdrawal of membership capital be conditioned on the Corporate's ability to meet all applicable capital requirements following withdrawal?
   Response: The application of capital standards and account provisions should be uniform for all Corporates to avoid gaming the system. Without some capital adequacy provision, it would promote the concept of "first one out" is paid and "last one out" is not. This would not be good policy for a cooperative business model.

<u>**Risk-based Capital and Contributed Capital Requirements**</u>

1. Should NCUA consider risk-based capital for Corporates consistent with that currently required of other federally regulated financial institutions?
   Response: Yes, however, there must be caution to make other business authorities consistent. If risk based capital requirements are applied, then commensurate business activities should be allowed to avoid an unfair competitive environment due to charter differences between banks and credit unions.

2. What regulatory and statutory changes, if any, would be required to effectuate such a change?
   Response: A line by line comparison would be required so as not to put Corporates and their NPCU members at an unfair disadvantage to for-profit banks.

3. Should a natural person credit union be required to maintain a contributed capital account with its Corporate as a prerequisite to obtaining services from the Corporate?

Response: Yes, as noted earlier, this would assure that competition between Corporates would be limited to those who support the Corporates through maintaining capital versus those looking to "cherry pick" rates and services. Care must be taken that NPCUs can have as many different accounts at other financial institutions outside of Corporates that do not require minimum contributed capital and who are not within the NCUA's regulation.

4. Should contributed capital be calculated as a function of share balances maintained with the Corporate? What about using asset size?
   Response: There are many ways to calculate this requirement. Caution must be exercised to avoid unintended consequences. The formula should also be simple to manage and explain. The regulator should allow various approaches to meet each Corporates business model. These are contractual arrangements between NPCUs and Corporates. The NCUA may need to set minimum standards.

<u>Permissible Investments</u>

NCUA is considering whether the Corporate investment authorities should be constrained or restricted. Presently, Corporates have the authority to purchase and hold investments that would not be permissible for natural person FCU members under Part 703 (or, in some cases, outside of what is authorized for a state chartered credit union).

1. Should the NCUA limit Corporates' investment authorities to those allowed for NPCUs?
   Response: No. This would severely restrict NPCUs ability to earn any competitive rate on their investments as they do not have the authorities that Corporates have. It is very unlikely that they would be granted these authorities due to rigorous requirements that the NCUA places on Corporates. The cooperative concept of aggregating authorities and risk is a good one that can be improved by aligning capital and risk taking at the same level. The restriction of authorities to equal NPCUs' authorities could lead to the demise of the Corporate System as capital retention and the same powers would provide no benefit to a cooperative model. The alternative, if this is accomplished, would be to increase authorities at the NPCU level so they can remain competitive. This could increase the risk to the insurance fund, and increase cost to NPCUs.

2. Should the NCUA prohibit certain categories of, or specific, investments?
   Response: No. Care should be taken, as noted previously to possibly expanding some authorities, while placing a framework of risk diversification and mitigation with any new rule.

Credit Risk Management

1. Should the NCUA limit the extent to which a Corporate may rely on credit ratings provided by Nationally Recognized Statistical Rating Organizations (NRSROs)?
   Response: No. The NCUA, other national regulators and Congress should instead focus on holding the NRSROs accountable for their lack of in-depth analysis, the lack of a 100-year event stress test and eliminate the potential conflicts rating agencies have with regard to payments for services. It is inconceivable that entities like Corporates would be required to develop these complex tools and acquire the resources necessary to make assessments that we should rely on them to provide. This would add inexcusable costs. Instead, fix the problem at the source and not generate additional or new problems.

2. Should the NCUA require more than one rating for an investment, or require that the lowest rating meet the minimum rating requirements of Part 704?
   Response: We have found using multiple ratings beneficial as no one model is predictive of the future. Multiple models give broader views and are often helpful. However, this also increases costs at the Corporate level. It must be noted that multiple ratings on investments or choosing the most conservative rating would not have prevented the current problems.

3. Should the NCUA require additional stress modeling tools in the regulation to enhance credit risk management?
   Response: Yes, however, this will add significant costs that NPCUs will have to pay for through lower dividends. The current regulation does not require Corporates to stress credit as we are required to stress interest rate risk and NEV. The additional testing should be considered. The current credit events are multiples of any expectation from history, and complicated by liquidity stresses from a non-functioning capital market. Regulations must consider requirements and flexibility under never anticipated events.

4. Should Part 704 be revised to lessen the reliance on NRSRO ratings?
   Response: No. NRSROs should be regulated as closely as financial institutions and those requirements strengthened. The method of a "common credit approach" makes comparability between counter-parties and understanding of risk common to owners.

5. Identify any other changes that may be prudent to help assure adequate management of credit risk. Considerations should include whether Part

704 should be revised to provide specific concentration limits, including sector and obligor limits.
Response: The NCUA must take care not to overly restrict authorities. Adequate risk diversification is the first step in a well managed portfolio; any regulation should provide flexibility to adjust diversification limits to meet economic and financial market conditions.

6. What specific limits would be appropriate for Corporates?
Response: This is impossible to answer without first determining what the role of Corporates will be in light of increased regulation and whether NPCUs will be competitively limited as a result. Corporates provide fundamental services for the majority of small and medium sized credit unions. These credit unions may not find alternative sources for products and services at acceptable costs if the NCUA regulated Corporates to a minimum risk level.

7. Should Corporates be required to obtain independent evaluations of credit risk in their investment portfolios?
   a. If so, what would be appropriate standards for these contractors?
Response: This may not be necessary, but may also help provide additional protection from this 100-year event happening in the future. If independent evaluations are required, there should be no requirement to duplicate these standards internally at each Corporate. The NCUA could contract with outside valuation firms for an independent review across all Corporates to meets its supervisory needs and that same information could be used by each Corporate.

8. Should Corporates be required to test sensitivities to credit spread widening, and if so, what standards should apply to that effort?
Response: Yes. This would be a good enhancement. These stress tests should be modeled after existing regulations related to NEV modeling. Most Corporate credit unions did monitor the aggregate risk of credit spread widening against the entire portfolio to previous historical credit spreads. However, today those credit stresses are 10 to 15 times wider than previous events in the past 70 years. A capital charge for the current event moving forward will raise lending rates and market premiums and reduce available credit in the market place. Careful consideration of the potential impact must be reviewed prior to establishing the guidelines.

<u>Asset Liability Management</u>

Under past rules, the NCUA required Corporates to perform net interest income modeling and stress testing. The agency is considering re-instating that requirement in light of the current market. Alternatively, the agency may consider some form of mandatory modeling and testing of credit spread increases.

1. Should the NCUA require Corporates to use monitoring tools to identify these types of trends, including specifically comments about tangible benefits, if any, which would flow from these types of modeling requirements?
   Response: Yes. Increased testing and modeling would be beneficial. However, this type of increased scrutiny would not have prevented the global meltdown that we are currently experiencing since all securities became illiquid and all spreads moved wider simultaneously. Understanding the required capital charge for these events would have caused more capital retention to meet the credit spread widening event.

Corporate Governance

1. Should the NCUA require that a director possess an appropriate level of experience and independence?
   Response: The regulators should not attempt to determine "appropriate levels of experience". These decisions and the legal responsibility should be on the Board of Directors, elected by their members to make these decisions. The NCUA should establish a regulation for a Board to have an active policy on experience levels and training requirements and hold them accountable for compliance. Independent Boards as modeled in the for-profit sector of financial institutions did not prevent the financial crisis. The current board structures at banks and broker dealers, which have been enhanced by Sarbanes-Oxley legislation and new transparencies, did not prevent the current market crisis.

   The NCUA should not require board members to be independent of their NPCU or Corporate Board. This is a cooperative system and should maintain that governance of "for the people and by the people." The NCUA should however, allow a NPCU or Corporate Board to retain outside directors if they so choose.

2. Should the agency set term limits, allow compensation for Corporate directors, and requiring greater transparency for executive compensation?
   Response: These are decisions that should be determined by each Board of Directors. Term limits are gaining popularity in the CU System and should be considered more a norm than an exception, but should be determined by a Board of Directors. Compensating Corporate Directors does not solve any current problems. Compensation is most often provided to attract qualified candidates and require their undivided attention and attendance on behalf of the

paying entity. If minimum qualifications were established and ongoing training required, we may be able to attract qualified talent easier if Corporates were permitted to compensate directors.

No one but the NCUA is interested in publicizing the salaries of Corporate CEOs. Public disclosure of CEO compensation would not solve any of the problems that NPCUs or Corporates face today. Corporates should be held to the same standard as NPCUs.

3. Is the current structure of retail and wholesale Corporate credit union boards appropriate given the Corporate business model?
Response: Cooperatives should be lead by the members who utilize the services of the cooperative. However, the NCUA should not limit directorship positions, based on FOM limitations or ownership. NPCUs and Corporates should be permitted, at the Board's discretion, to utilize experienced and qualified "outside directors", to assist with the leadership role. The current requirements at the wholesale level need to be reconsidered, as they are based on equal distribution of asset size versus qualification and experience. Boards should consider many factors in determining qualifications, but limiting positions by asset size is not conducive to good Board governance.

For example, there is currently a requirement that US Central's Board be comprised of a specific number of small, medium and large Corporates, as well as representation from related entities to Corporates like trade associations. This model provides for "fairness" of equal representation of size, but does not always obtain the best available talent. It merely models the same concerns voiced in other NPCU-owned organizations related to asset size. The current regulatory governance requirements also do not provide for outside directors which may have experience in areas that CUs or Corporate CUs do not have experience and expertise in, like wholesale or global financial services. There should be no limitations on obtaining the best available Board talent, except as the governance structure would require.

4. Should NCUA establish more stringent minimum qualifications and training requirements for individuals serving as Corporate credit union directors?
    a. If so, what should the minimum qualifications be?

Response: It appears that the NCUA does not require any minimum qualifications or training requirements for individuals' service on Corporate boards at this time. Therefore, any minimum requirement would be "more" and beneficial. There could be a national standard for minimum training hours for NPCUs and Corporate directors alike.

Establishing such minimum standards would support compensation for directors.

5. Should the NCUA establish a category of "outside director," (persons who are not officers of that Corporate), officers of member natural person credit unions, and/or individuals from entirely outside the credit union industry?
    a. Should the NCUA require that Corporates select some minimum number of outside directors for their boards?

   Response: The NCUA should permit the use of "outside director" and leave the decision of whether to utilize it, or how many to retain, up to each Board of Directors and not require a minimum number of outside directors. The NCUA should permit each Corporate Board to add the talent they feel is necessary under the circumstances, without NCUA limitation.

6. Should U.S. Central be required to have some directors from NPCUs?
   Response: This would be an acceptable. However, as stated earlier, it is more important to have the right talent, versus representation. The business model and lines of business of Corporates is different from the consumer-oriented loan model that NPCUs manage. Having the most experienced and knowledgeable executive is more critical than where the representation comes from, particularly considering that we are all cooperatives, with cascading leadership responsibilities and ownership bound by legal requirements of fiduciaries.

7. Comment is also sought on whether Corporate directors should be compensated, and, if so, whether such compensation should be limited to outside directors only.
   Response: Compensating Directors without minimum qualifications would not be effective. If compensation is provided for in the regulations, it should be for all directors and not limited to only outside directors.